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SUBJECT: EXPLAINING MOROCCO'S "LIMITED IMMUNITY"

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¶C. RABAT 853

Classified By: Econ Counselor Stuart Smith, Reasons 1.4 (b) and (d).

¶1. (SBU) Summary: Leaders in Morocco's financial sector remain confident that it is sheltered from any direct problems as a result of ongoing turmoil in world financial markets. The "immunity" stems less from the sector's inherent virtue, bankers tell us, than from the still limited nature of Morocco's integration into the world financial system. They point to two key factors: continued controls on Morocco's capital account, which limit the ability of Moroccan individuals and institutions to invest abroad, and the country's longstanding balance of payments' surplus. Additional strengths, they argue, include the limited foreign participation in the Casablanca Stock Exchange (CSE) and the Bank al-Maghrib's strengthened oversight of the sector. Our contacts concede that Morocco's immunity is not total: they believe the country will suffer in the medium term from follow-on effects from a slowdown in Europe. If the recession is of short duration, one seasoned observer told us, however, Morocco's "improved economic fundamentals" should see it through. End Summary.

¶2. (SBU) In a recent series of meetings in Rabat and Casablanca, Econ Counselor and Econoffs found that leading bankers and analysts largely share the government's belief that the Moroccan financial sector is sheltered from "direct contagion" from the ongoing global financial crisis. Our interlocutors emphasized that the "immunity" stems not from "superior insights or intelligence," but from the fact that continuing controls on Morocco's capital account limit the ability of Moroccan banks and other financial insitutions to invest in the instruments that are at the root of the crisis. Such rules, the Bank al-Maghrib's Banking Supervision Chief, Abderrahim Bouazza, reminded us, make it impossible for banks to have more than 20 percent of their own funds and 5 percent of their balance sheet overseas. Insurance companies and other financial insitutions face similar limits. Moreover, Moroccan regulations strictly regulate the types of instruments in which banks can invest, limiting them generally to government bonds and investment grade assets in OECD countries. As a result, Moroccan banks have little foreign exposure on either the asset or liability side.

¶3. (SBU) An additional benefit of the stringent capital control regime, Idriss Smires, the Deputy President of the Banque Centrale Populaire (one of Morocco's three leading banks), told us, is that it "prevents an attack on the Moroccan dirham," and thus insulates the country from the threat of devaluation of the currency, the mechanism through which many other emerging economies have been hurt by the crisis. Morocco's longstanding (though narrowing) balance of payments' surplus and the limited foreign stake in the Casablanca Stock Exchange both provide additional defensive

reinforcement on this front, he said. (Note: Foreign investment represents only 7 percent of CSE's transaction volume. End Note.) Smires cautioned against an exaggerated sense of triumphalism on account of these advantages, however. "We are in a different system than countries with open economies," he said, something that has limited economic growth during good times but conversely now protects Morocco in these changed circumstances.

¶4. (C) Smires and Bouazza also pointed out that while advanced in comparison to their regional competitors, Moroccan banks engage in much more basic transactions than do their European and American counterparts. Most importantly, with a captive market, there has been little pressure to branch out into complicated derivatives or to engage in proprietary trading. The banks have been able to achieve solid profits carrying out transactions on behalf of their clients, so they feel "why take risks" when these earnings are sufficient. As for the fifth of the banking sector that is controlled by foreign (largely French) banks, Smires noted that it has been tightly controlled by its French parent companies, with the result that it has little downside risk, though these French banks have lost market share to their Moroccan competitors.

¶5. (SBU) Smires and Bouazza pointed to a number of other reforms that have strengthened Morocco. As evidenced by the clean bill of health accorded the Moroccan banking sector in the IMF's most recent Article IV Consultation report, they argued that Moroccan banks are much stronger than they were a decade ago. State banks have been cleaned up, the level of non-performing loans has been reduced, and banks have largely provisioned for them. Banking supervision, they argued, is also much improved, a point that the IMF consultation report echoes. Bouazza stressed that the bank is proactive, closely monitoring problem areas. When potential risks emerge, it has acted quickly to limit them. It thus stepped in last year when banks began offering residential loans for more than a hundred percent of the value of a property. It has also sought to ensure that banks clearly explain the possible risks of adjustable-rate loans to their clients, to ensure that they make an informed decision.

¶6. (C) If Morocco is protected from "direct contagion" from the financial crisis, Smires was at pains to stress that it will be impacted in the medium term by the emerging global economic slowdown. He expressed concern that by stressing the "immunity" of Morocco's financial sector, Moroccan authorities are not adequately preparing the public for the inevitable hit Morocco will take as its primary European market slips into recession. (Note: Officials at the Finance Ministry did take advantage of a November 13 economic conference hosted by Morocco's leading bank, Attijarawafa, to highlight these risks. End Note.) Like others we have consulted, Smires concurs that key transmitters will be exports, tourism revenues, foreign direct investment, and transfers from Moroccans resident abroad. Counterintuitively, he noted that in the case of a short downturn, Moroccan expatriates have historically stepped up the tempo of their transfers home, as occurred in 2001 following 9/11. This slowdown, he judged, however, will be more protracted, and will undoubtedly impact this important component of Morocco's balance of payments. Similarly, tourism will also slow, as will investment, particularly in higher end real estate developments in cities like Marrakech and Tangier.

¶7. (C) Despite these vulnerabilities in the real economy, Smires concurred that Morocco is well positioned to ride out the storm as a result of reforms over the past decade, and as a result of the fact that its international profile lowers risk perceptions among foreign partners. While conceding that an early impact from the financial crisis was a tripling in the spread on Morocco's bonds over comparable Euro bonds from 55 to 160 basis points (ref A), he pointed out that this is just a fraction of the 600 and 800 point spreads that currently face economies like Dubai and Russia that are more dependent on foreign financing. He pointed to ongoing

infrastructure projects and initial hints that the agricultural season will be a good one as possible shock absorbers that will cushion Morocco's potential "hard landing," but still saw growth slipping to 2.5 to 3 percent in 2009 and 2010. "I am pessimistic by nature," he said. Others, however, including the Moroccan Conjunctural Center (CMC) have predicted a similar slowdown, and the Finance Ministry has already lowered Morocco's growth target for 2009 below 6 percent.

¶8. (C) Comment: Our banking sector contacts concur that Morocco's financial sector is well positioned to ride out the ongoing financial crisis, but that the increasingly open Moroccan economy will take a hit, particularly if Europe enters a protracted recession. Already, Moroccan manufacturers are reporting cancelled orders, and most expect the impact to also begin showing up in remittance, investment, and tourism flows over the next three to six months. An additional concern is that the international crisis may slow plans to gradually liberalize Morocco's capital account, something that Smires and others believe is in Morocco's interest, "if it is done properly." If there is a silver lining in the gloomy mid-term forecast, it is that Morocco is as well-prepared as it has ever been for the challenge, and that for the moment the surging inflation that earlier this year sparked fear of growing social unrest has been tamed. Prices, Smires reminded us, have always had a more volatile impact in Morocco than other difficulties, and at least on that front pressure has eased. End comment.

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